

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
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FISCAL IMPACT STATEMENT

LS 6674

BILL NUMBER: HB 1948

DATE PREPARED: Feb 2, 2001

BILL AMENDED:

SUBJECT: Gross income tax exemptions.

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FUNDS AFFECTED: X

X

**GENERAL
DEDICATED
FEDERAL**

IMPACT: State

Summary of Legislation: (A) This bill provides that amounts received from the sale, lease, or other transfer by or to an electric utility or a general district REMC of an interest in an electric generating facility that at the time of the sale, lease, or transfer is subject, at least in part, to certain "safe harbor" sale-leaseback provisions under the Internal Revenue Code is exempt from gross income tax to the extent of any mortgage, security interest, or similar encumbrance on the interest in the facility.

(B) The bill provides an exemption from the gross income tax for amounts received under a "qualified investment" that is acquired for the purpose of enabling a lessee to pay the basic rent and exercise price of a purchase option under the lease of an interest in an electric generating facility that, at least in part, is subject to "safe harbor" sale-leaseback provisions of the Internal Revenue Code.

Effective Date: January 1, 2001 (retroactive).

Explanation of State Expenditures: The Department of State Revenue will have minimal administrative expenses in revising tax instructions or bulletins. These expenses will be covered under its existing budget.

Explanation of State Revenues: *Summary:* The bill provides an exemption from gross income tax for income received as part of a transfer of property [the property being part of an electric generating facility] where the income received [termed the "qualified investment"] is only to be used to pay the lease payments during the term of the lease and, if sufficient, be used for the purchase of the property at the end of the lease term. This exemption would only apply to property subject to leases entered into under Section 168(f)(8) of the Internal Revenue Code of 1954, [IRC], termed "safe-harbor" leases. These leases provide tax benefits as part of the sale and lease-back provisions applicable to the transfer, and were only provided for under federal law between 1980 and 1984.

(A) The bill clarifies that income received from the transfer of electric utility generating property [as described above] is exempt from the gross income tax, to the extent of any mortgage, security interest, or

similar encumbrance. There is in current law an exemption for the income received under the transfer of real property, to the extent of the mortgage on that property. However it is not clear that property used for the generation of electricity would be wholly covered under the existing real property exemption. SECTION 1 of the bill exempts the income derived from the transfer of electric generating facility property specifically, but only to the extent of the mortgage.

(B) The bill also provides a tax exemption which would apply to a “qualified investment” where the amount of the investment [a substantial part of the value given to the utility to acquire rights to the property] is “substantially identical” to the amount of cash needed by the utility [termed the “qualified lessee”], that when invested, is sufficient to make the lease payments over the term of the lease. In addition, a part of the qualified investment may remain at the end of the lease term and may be used to purchase back the electric generating property. Only those portions of the cash used to fund lease payments and re-acquire the property at the end of the lease period are included in the term “qualified investment” and therefore only the income generated from those amounts are exempt from the gross income tax.

The terms of a lease which meets the provisions of this section constitute a method of financing an electric generating facility, regulated under IC 8-1-2 or IC 8-1-13. Consequently, the revenues which would be generated as part of the terms of this lease and for which the bill provides an exemption would normally not arise as part of the entity’s operations as an electric utility and therefore would not be subject to the gross income tax under, IC 6-2-1. The application of this exemption is further limited in that only property subject to a safe-harbor lease under Section 168 (f)(8) of the Internal Revenue Code of 1954 may qualify. Since that section of the IRC has not been in force for approximately 16 years, the application of the exemption is extremely narrow. In addition, if this exemption is not granted, another method of financing will need to be found.

State revenues would be impacted if this transaction is completed. The utility selling the portion of its generating facilities will pay gross income tax on the income in excess of the mortgage. The income generated from the qualified investment also will be subject to the supplemental net income tax and may provide additional revenue to the state. It is not clear that an alternative method of financing would generate these tax revenues.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue.